November 15, 2013

Mr. Grant Boyken
California Secure Choice Retirement Savings Program
915 Capitol Mall, Room 110
Sacramento, CA 95814
Via e-mail: grant.boyken@treasurer.ca.gov

Attn: Secure Choice RFI #13-01

Dear Mr. Boyken,

The Securities Industry and Financial Markets Association ("SIFMA")[1] appreciates this opportunity to respond to the Request for Information ("RFI") issued by the California Secure Choice Retirement Savings Investment Board about SB 1234, the California Secure Choice Retirement Savings Program[2]. Our members provide a variety of services to retirement plans and IRAs.

California financial services firms - which directly employ 545,000 workers in the state and indirectly employ countless others - currently offer a wide variety of retirement savings alternatives, including 401(K) plans, 403(b) plans, 401(a) plans, 457(b) plans, SIMPLE IRAs, SEP IRAs, and traditional IRAs. Smaller employers and individual employees tend to gravitate to IRAs because they are low-cost, straightforward and easy to administer. This program would create a new state-run structure that would directly compete for business with a wide range of California financial services firms and retirement plan providers. This would directly affect the livelihoods of securities firms and individual brokers, insurance and life insurance companies and individual agents, plan providers and their employees, and others in the financial services industry.

[1] The Securities Industry and Financial Markets Association (SIFMA) brings together the shared interests of hundreds of securities firms, banks and asset managers. SIFMA's mission is to support a strong financial industry, investor opportunity, capital formation, job creation and economic growth, while building trust and confidence in the financial markets. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association (GFMA). For more information, visit www.sifma.org.
[2] SB 1234, Chapter 734, 2012.

While we believe there are some retirement savings challenges and the state and federal government have a vital role to play in addressing them, we do not believe that a state-run plan for private sector workers is the right approach for the state. Instead, we believe some of these challenges could be addressed by additional support from the state and federal government to encourage more employers to offer these plans and to educate employees about the benefits of early and regular saving for retirement.

We brought our members together to work on responding to some of the specific questions asked by the Board. A particular challenge we found was in trying to respond without having sufficient detail about the direction of the program. Many of the questions concerning products, costs and investments would be premature to discuss since the legal structure of the plan and the operational issues have not yet been addressed. As a result, our answers are limited by those constraints.

Plan Structure

We believe creating such a program would be a challenge under current law. Given the legal framework of ERISA and the Department of Labor (DOL) Advisory Opinion 2012-01A[3], it is likely not possible to implement a mandatory program through employers that is exempt from the Employee Retirement Income Security Act of 1974, as amended ("ERISA"). Because the statute prohibits the Board from implementing the program if it is determined that the program is an employee benefit under ERISA, we would recommend that the Board submit an advisory opinion request to the Department of Labor as a critical first step.

If such confirmation is not obtained in advance, the state of California, as the plan sponsor, and employers in the state could be subject to significant risk of belated or even retroactive application of ERISA if the DOL were to determine that ERISA applies. The risk includes substantial fines and possible criminal liability in the event of ERISA violations. There would also be the cost and repercussions of undoing the program as required by California law.

The enabling statute also prohibits implementation if the IRA arrangements offered fail to qualify for the favorable tax treatment ordinarily accorded to IRAs under the Internal Revenue Code. The Board should be aware that even if the program is determined exempt from ERISA by the Department of Labor, the plan could still be subject to many of the ERISA requirements that are included in the Internal Revenue Code. Therefore, guidance from the IRS is also necessary. Failure to obtain a favorable determination from the IRS prior to program implementation could result in adverse tax impacts for employers and employees and would be in violation of SB 1234 as enacted.

[3] http://www.dol.gov/ebsa/regs/aos/ao2012-01a.html

Investment Options

Because the State will be acting as the plan sponsor in creating this plan, it would need to take a look at the types of employees who would be investing in this plan and determine what type of plan best suits this group's needs. Depending on the risk tolerance of the individuals who would be participating in this plan, this could include giving greater weight to passive investments or greater weight to active investments. Insured interest or insured income products may or may not be appropriate depending on the risk tolerance of individuals. The various structures and provisions must satisfy the requirements of both insurance and securities laws. An appropriate legal structure can be determined and recommendation can be made once there is specificity on the structure and operation of the program. The Board should also note that the nature of any guarantees is highly dependent on interest rate markets and actuarial factors.

In terms of the questions about risk management, it is important to recognize the positive role ERISA has played in protecting plan participants in ERISA-covered plans. ERISA sets forth many requirements regarding prudence and risk management to provide protection of benefits. This was done, in part, through keeping plan assets separate from the control or influence of sponsoring employers, the implementation of fiduciary processes, and reporting and disclosure requirements. Prior to ERISA, there were incidents where people lost retirement plan savings due to a diversion of assets or underfunding.

We suggest the Board consider all of the implications for the State if the plan is deemed to be outside of ERISA and suggest the Board adopt a risk management structure consistent with ERISA regardless of the determination. Liability and risk do not disappear in the event that the plan is deemed ERISA exempt.

Prudent plan management includes making decisions solely in the best interest of plan participants, following the plan document, and documenting procedures. The Board should look to ERISA's well-established procedures as part of managing the plan prudently, including making timely contributions, mapping and defaulting investment options, analyzing and understanding plan expenses, reporting, and more.

Plan Design and Features

Determining the appropriate default contribution level depends on whether one is looking to replace individuals' income, or just provide a small additional savings account. Our members believe that a full 10% of income is the minimum contribution level necessary to accumulate adequate retirement funds.

A default contribution level of 3% of income would be insufficient. Assuming an annual guaranteed rate of return of 3% for 40 years on those contributions generates a retirement

income replacement of less than 10% of pre-retirement wages. It would take an individual contributing 3% for over 20 years to provide even a 5% income replacement based on the same assumptions. The Board should consider the costs and risks of the program relative to these marginal levels of income replacement.

In terms of leakage, we suggest the Board consider adopting certain existing distribution rules on IRAs. IRAs under Federal law have a 10% excise tax penalty for distribution before age 59 ½ and a requirement that distributions begin by age 70 ½. It will be important to educate California residents about the benefits of leaving the money in the plan until retirement age. Without proper education, California residents enrolled in the program that withdraw amounts prior to age 59 ½ will wind up paying higher Federal taxes on those amounts than if the program was not in existence and they had saved that money outside of an IRA.

Costs and fees

In terms of the costs, SIFMA members believe that the current private market is highly competitive with many providers actively providing services in plans for individuals and employers at an affordable rate. Our members are happy to cite specific examples of their existing products and services and their costs at the Board's request.

In order to provide estimates of costs and fees under the program, our members would need additional information. One-size-fits-all products and pricing structures do not exist and would be inappropriate under both state and Federal statutes and regulations.

Our members would need knowledge of the legal structure and administrative processes of the program, such as:

- Is the structure retail or institutional? A retail arrangement exists where a provider has a contractual relationship directly with an individual. An institutional arrangement exists where the contracts are between a provider and an employer, or a trust.*
- Does the group structure have commonality of procedures at the program or employer level? For example, will payroll functions run through a central clearing house, or from each employer to the provider?
- What are the communication and educational needs of the plan participants?
- What is the demographic information?
- How many investment options are going to be offered, and what are (if any) the limitations on transfers between the investment options?
- Is there an ability to take out loans?
- Is it quarterly, weekly or daily accounting?

In addition, it is important to note that it will be challenging for the State to receive the benefits of economies of scale because the State would need to be connecting directly with many individual employers and each of their systems and employee mix.

Administrative issues

We do have some concerns about administering this particular program, in terms of costs as well as compliance, depending on how this program ends up being designed.

Once a plan is established, the state would incur ongoing operational, oversight, compliance and insurance costs. We are aware of two studies that have examined the cost of creating a state-sponsored plan. One study, authored by the Maryland Supplemental Retirement Plans ("MSRP") in 2007, concluded that a "State sponsored voluntary accounts program is potentially viable but will require significant long-term state expense." A 2009 Washington State report estimated that a state sponsored basic IRA plan that provided retirement savings options to 20,000 participants would have start-up costs of $1.9 million and annual on-going state costs of almost $1.4 million.

Liability and cost are significant considerations the Board should take into account when evaluating the program. While the bill sets aside one percent (1%) of the total program fund to administer the program trust, we believe it is highly likely that administrative, compliance, insurance, and other costs will materially exceed that amount. For example, fiduciary insurance alone is a necessary expense that by itself could exceed the 1% allocated for such expenses. According to FiduciaryInsurance.com, plan fiduciaries now surpass the medical profession as a target for litigation, the average claim has surpassed $800,000, and defense costs have risen 471% in the last five years. Premiums are dependent on a number of factors including amount of coverage sought, amount of assets, number of participants, and type of plan.

Legal issues

As noted earlier in our letter, the Board must seek an advisory opinion from the DOL addressing the issue of the application of ERISA, as well as seeking a private letter ruling ("PLR") from the IRS to address the issues of the Internal Revenue Code. It is essential favorable letters from both the DOL and IRS be received prior to introducing legislation in the General Assembly. If such confirmation is not obtained in advance, the state and employers in the state are subject to significant risk of retroactive application of ERISA if the DOL were to determine that ERISA applies. The risk includes substantial fines and possible criminal liability in the event of ERISA violations.

Also, the Board should consider the reasons in 1974 for the adoption of ERISA as a protective statute, and the potential implications of developing a program outside the scope of those protections.

Timeline

The CA Investment Board would be well served to wait until they have received formal guidance from the DOL in the name of an advisory opinion, and from the IRS through a private letter ruling before taking any further steps.

We would be happy to make ourselves available for any follow-up questions. Please do not hesitate to contact Kim Chamberlain at (212) 313-1311 or kchamberlain@sifma.org, or the undersigned if you have any questions or if we can be of further assistance.

Sincerely,

Lisa J. Bleier
Managing Director
Securities Industry and Financial Markets Association